



**FOR INFORMATION**

**PUBLIC**

**OPEN SESSION**

**TO:** Business Board

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**DATE:** March 7, 2014 for March 31, 2014

**AGENDA ITEM:** 5.

**ITEM IDENTIFICATION:**

Debt Strategy Annual Review.

**JURISDICTIONAL INFORMATION:**

Pursuant to Section 5 (1.) (b.) of the Business Board Terms of Reference, the Business Board has responsibility for reviewing regular reports on matters affecting the finances of the University and on financial programs and transactions.

**GOVERNANCE PATH:**

1. Business Board (March 31, 2014)

**PREVIOUS ACTION TAKEN:**

The borrowing strategy was initially approved by Governing Council in June 2004. A revision of this debt strategy was approved in November 2012.

**HIGHLIGHTS:**

The debt strategy approved by Business Board in November 2012 established a single debt policy limit including both internal and external debt, with fungibility between them. The debt policy limit is to be calculated annually using the 5% debt burden ratio (debt service cost divided by total expenditures) as a key determinant, and the 0.8 viability ratio (total expendable resources divided by total debt) be taken into consideration in setting that debt policy limit. The purpose of this report is to assess the continued prudence and effectiveness of this debt strategy.

At April 30, 2013, the 5% debt burden ratio resulted in a total debt policy limit of \$1,400 million. The associated viability ratio with this debt policy limit was 0.85, higher than the desired

threshold of 0.8. Of the \$1,400 million, \$350 million is set to be issued from internal sources with the remaining \$1,050 million to be issued from external debt. Actual outstanding debt at March 31, 2014 was \$1,025 million of which \$304 million was internal and \$721 million, external. At March 31, 2014, \$1,184 million of borrowing room has been allocated to capital projects and other requirements, leaving \$216 million for future initiatives. Planned future capital projects will require \$36.5 million beyond the \$216 million currently available.

Based on projected financial factors such as total expenditures and expendable resources, the debt policy limit, determined using a 5% debt burden ratio, will increase by an additional \$200 million to \$1.6 billion by 2019. This borrowing room will be sufficient for planned projects and will leave room for strategic academic priorities associated with capital projects not yet planned. The increase in the debt policy limit is due to anticipated stable cost of borrowing along with anticipated growth in expenditures. Material increases in interest rates would negatively impact this projection and would lower the debt limit. Furthermore, the associated viability ratios for the debt limits at 5% debt burden ratio are expected to be below the desired 0.8 from 2014 to 2016, mainly due to an unusually large contribution to pension plans in 2014, followed by modest increases in reserves. If we were to adjust the debt policy limit to a viability ratio of 0.8 for the years 2014 to 2016, the debt policy limit would be reduced in those years between \$90 million (2014) and \$51 million (2016). Even with these adjustments, the reduced debt policy limit should provide enough financing for the current planned projects plus future initiatives.

To assess the prudence of the debt policy, we have benchmarked the University's debt policy limits, actual external debt and key financial ratios to those of selected Canadian universities and to Moody's U.S. Public College and University Medians (Fiscal 2012). In summary, compared to selected Canadian universities, UofT has a higher proportion of debt service costs to total expenditures. In terms of expendable resources to pay outstanding debt, UofT also has lower expendable resources to debt ratios. However, compared to U.S. universities, UofT has a lower debt service cost than the median of universities with our same credit rating (Aa2), and higher expendable resources to debt than the median of universities with our same credit rating. Canadian universities have not traditionally relied on debt-financing to the same extent as U.S. universities and this is reflected in the ratios.

The current debt strategy has been in place for just over one year. This first annual report on the functioning of the strategy demonstrates that, provided interest rates remain relatively stable, it will deliver the debt levels needed to support the University's capital needs within the affordability parameters that we have set ourselves.

**FINANCIAL IMPLICATIONS:**

None

**RECOMMENDATION:**

For information.

**DOCUMENTATION PROVIDED:**

Debt Strategy review March 31, 2014



UNIVERSITY OF  
**TORONTO**  
**Debt Strategy**

**Review**  
**March 31, 2014**

## University of Toronto Borrowing at a Glance to March 31, 2014

Financial Ratios in accordance with Policy	Total	Internal Component		External Component
		Pension Debt	Other Debt	
Debt burden ratios:				
Debt policy limit at April 30, 2013	5.0%			
Actual debt outstanding at March 31, 2014*	3.8%	0.5%	0.8%	2.5%
Viability ratios:				
Debt policy limit at April 30, 2013	0.85			
Actual debt outstanding at March 31, 2014*	1.17	8.52	7.31	1.66
<b>Monitoring debt burden + pension special payments</b>				
Actual debt outstanding at March 31, 2014 plus special pension payments as % of total expenditures*	6.4%	3.1%	0.8%	2.5%

\*Calculated using the Total expenditures or Total expendable resources at April 30, 2013 and special pension payments for the year ended April 30, 2013

Debt Policy Limit April 30, 2013	Total in Millions	Internal Component		External Component
		Pension Debt	Other Debt	
Debt Policy Limit	1,400.0	150.0	200.0	1,050.0

Allocations	Total in Millions	Internal Component		External Component
		Pension Debt	Other Debt	
Opening balance at February 28, 2014	1,183.6	150.0	200.0	833.6
Approved by Business Board on March 03, 2014	-	-	-	-
Change of allocation on previously approved projects	-	-	-	-
Closing balance at March 31, 2014	1,183.6	150.0	200.0	833.6
<b>Unallocated</b>	<b>216.4</b>	-	-	216.4

Actual Debt Outstanding	Total in Millions	Internal Component		External Component
		Pension Debt	Other Debt	
Opening balance at February 28, 2014				
Debentures due 2031 to 2051	710.0			710.0
Other external debt	11.0			11.0
Internal debt	305.1	140.7	164.4	-
	1,026.1	140.7	164.4	721.0
Changes	(1.1)	(0.3)	(0.8)	-
Closing balance at March 31, 2014	1,025.0	140.4	163.6	721.0

### **Definitions:**

**Debt** includes all long-term external and internal borrowed funds obtained by any means (e.g. debentures, bank loans) and excludes letters and lines of credit and all short-term and medium term internal financing for purposes such as construction financing and fund deficits.

**Debt burden ratio**, key determinant of debt policy limit, equals interest plus principal divided by total expenditures.

**Debt policy limit** is the maximum debt that can be taken on based on a debt burden ratio of 5%.

**Viability ratio**, to be taken into consideration in setting debt policy limit, equals expendable resources divided by debt. The debt strategy has set a preference of a viability ratio of 0.8 or greater.

**Allocations** include borrowing approved by Business Board, plus contingency for donations targets and pledges.

**Actual debt outstanding** is the sum of internal loans issued from internal debt plus actual external debt issuance.

**Expendable resources** consist of the sum of unrestricted deficit, internally restricted cash reserves, internally restricted endowments and deferred contributions less outstanding loan issued for pension funding.

## Table of Contents

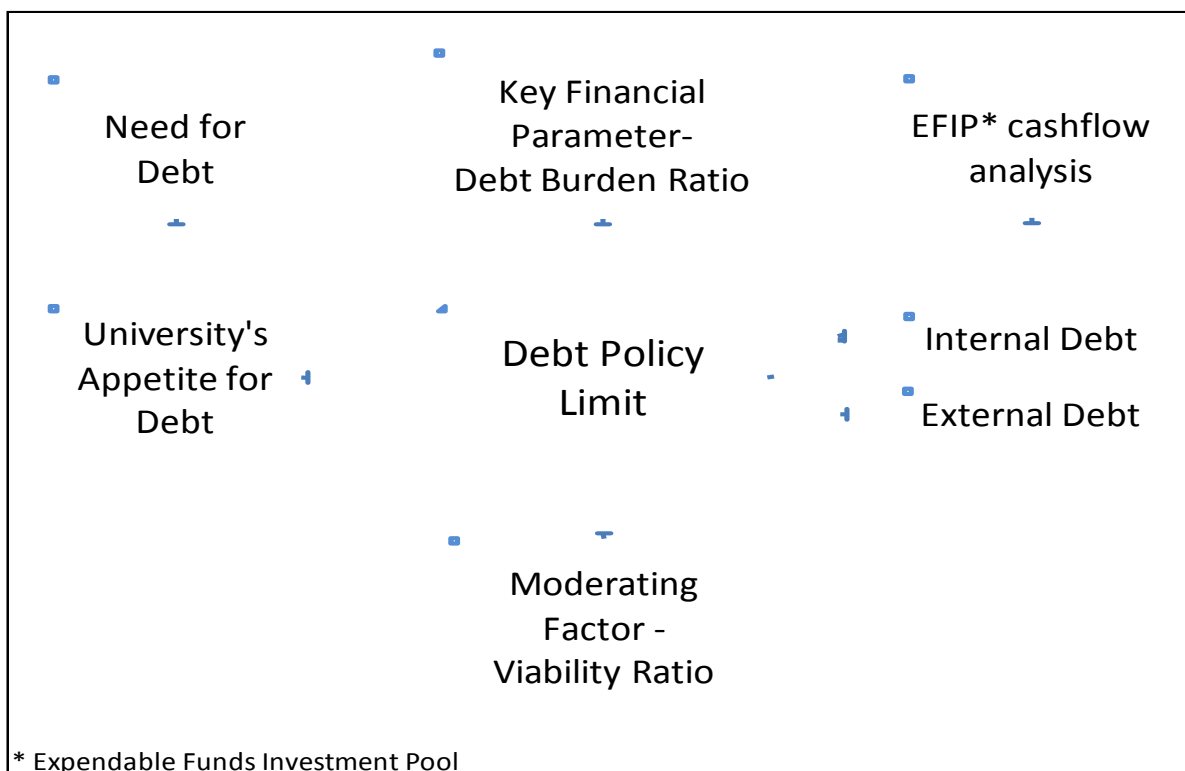
Introduction and purpose of report.....	Page 4
Elements of current debt strategy.....	Page 5
Current status.....	Page 6
Assessing debt policy limit to debt needs .....	Page 8
Financial parameters.....	Page 12
Benchmarking.....	Page 16
Credit ratings.....	Page 20
Internal debt.....	Page 22
External debt and planned repayment of debentures.....	Page 23
Conclusion .....	Page 24

## INTRODUCTION AND PURPOSE OF REPORT

The University of Toronto's debt programme acts as an integral component of the University's overall strategy to accomplish its academic mission by leveraging resources available to enable needed capacity growth and to provide quality enhancements of physical facilities.

Debt has been strategically managed as a scarce resource that must be carefully utilized to support revenue generating assets to the greatest extent possible.

In November 2012, a revised debt strategy was approved by the Business Board, replacing the strategy in place since 2004. It takes into account the need for debt and the University's appetite for debt and the financial parameters appropriate for the University of Toronto.



In summary, it was approved that **the debt policy limit be calculated annually using the 5% debt burden ratio as a key determinant, and the 0.8 viability ratio be taken into consideration in setting that debt policy limit.** All other elements of the debt strategy, its associated processes and procedures, and the Business Board approvals that are currently in place remained unchanged. The purpose of this report is to assess the continued prudence and effectiveness of this debt strategy.

## ELEMENTS OF THE CURRENT DEBT STRATEGY

The current debt strategy establishes a single debt policy limit including both internal and external debt, with fungibility between them. This debt policy limit is determined on the basis of debt affordability (measured using the debt burden ratio) and moderated when necessary and appropriate by debt capacity (measured using the viability ratio). The key elements of the current strategy are:

- **Debt** includes all long-term external and internal borrowed funds obtained by any means (e.g. debenture, bank loan), and excludes letters and lines of credit and all short-term and medium term internal financing for purposes such as fund deficits. External debt includes all funds borrowed from third party lenders while internal debt includes funds borrowed by the University from its Expendable Funds Investment Pool (EFIP).
- **The total maximum debt limit** is calculated annually using the debt burden ratio (principal plus interest divided by total adjusted expenditures) of 5%.
- **Consideration is given to moderate the debt policy limit** if the viability ratio (expendable resources divided by debt) associated with that maximum debt limit is below 0.8.
- **The internal debt component** is currently set at \$350 million. This amount can be increased or decreased based on borrowing needs and cash flow availability. An upper limit of 40% of EFIP has been established to recognize the need for liquidity and to provide for any possible future changes in cash flow patterns.
- **An additional metric is calculated to monitor** the combined impact of debt service on borrowed funds plus special pension payments, given the obligation to fund the large pension deficit<sup>1</sup>.
- **Credit ratings are** excluded from policy determination.
- **A self-imposed internal sinking fund** accumulates funds to repay debentures at maturity.
- **The borrowing method** (e.g. private placement or other method) is determined by the senior officer responsible for financial matters.
- **The internal borrowing programme** is determined, managed and operated by the University's administration. The senior officer responsible for financial matters is authorized to issue internal loans from either internal or external debt for projects where borrowing has been authorized by the Business Board.

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<sup>1</sup> Pension contribution strategy approved by Business Board in May 2012.

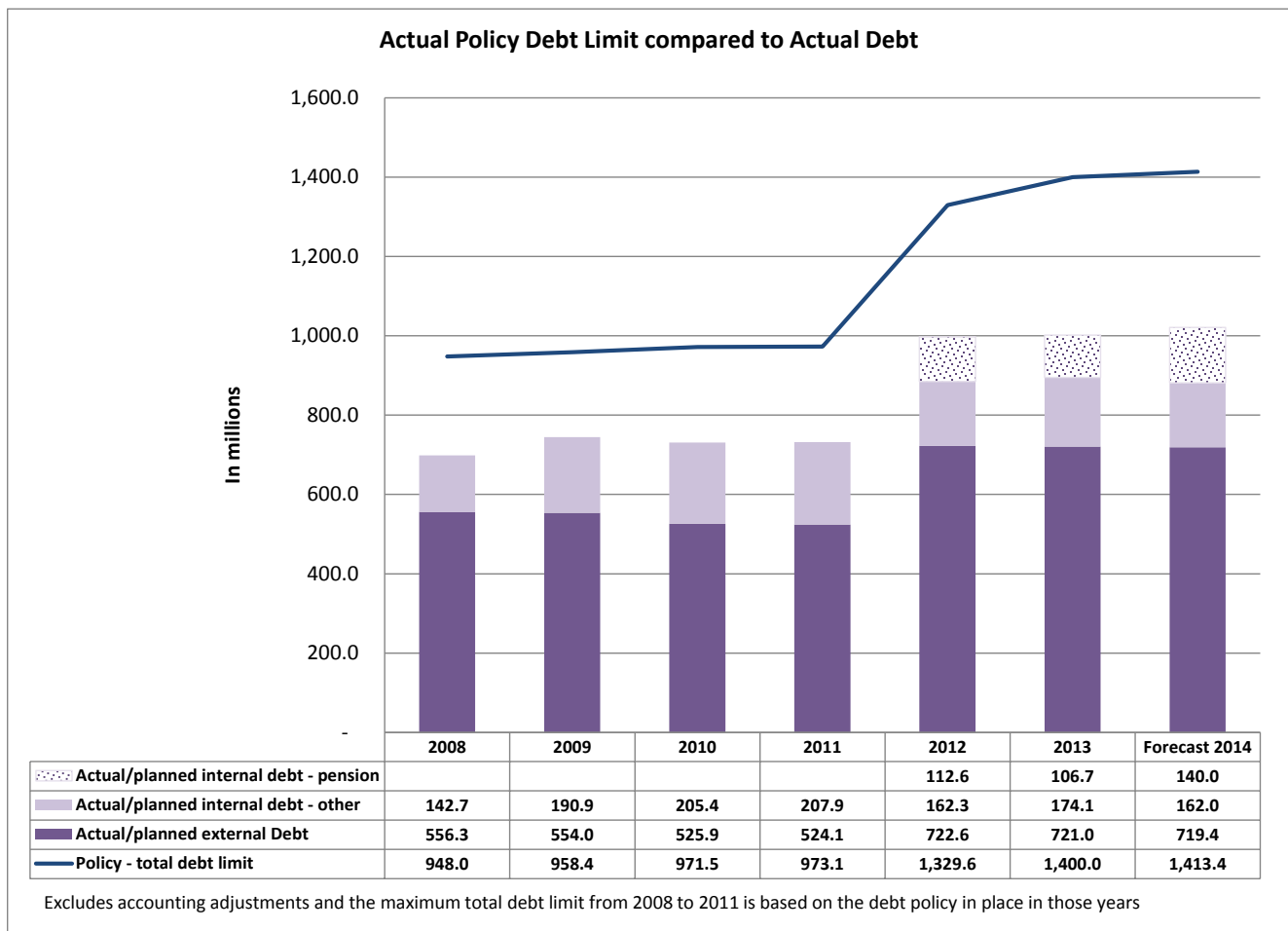


## CURRENT STATUS

### Debt Policy Limit:

The debt policy limit is updated annually at April 30. At April 30, 2013, the 5% debt burden ratio resulted in a total debt policy limit of \$1,400 million. The viability ratio associated with the 5% debt burden ratio was 0.85, which is higher than the desired lower threshold of 0.8; and therefore, no adjustment was made to the \$1,400 million debt limit.

Internal debt is currently set at \$350 million, representing 28.7% of the EFIP balance of \$1,220 million at April 30, 2013, which is below the 40% upper limit for EFIP. \$150 million of the \$350 million has been allocated for pensions and the remaining is allocated for other projects. This leaves an external debt component of \$1,050 million (\$1,400 million minus \$350 million).



## Allocations<sup>2</sup> to capital projects and other requirements:

At March 31, 2014, the Business Board has allocated \$1,183.6 million to capital projects and other requirements. With the annual \$1,400 million debt limit set in April 30, 2013, this leaves \$216.4 million to be allocated to future capital projects.

## Actual outstanding internal and external debt:

At March 31, 2014 there was \$1,025 million of total outstanding debt: \$721 million (excluding accounting adjustments) in external long-term debt and \$304 million in internal debt, as follows:

	Internal Debt for Capital and Other	Internal Debt for Pensions	Total Internal Debt	External Debt	Total
<b>Policy Limit</b>	200.0	150.0	350.0	1,050.0	1,400.0
<b>Allocations</b>	<u>200.0</u>	<u>150.0</u>	<u>350.0</u>	<u>833.6</u>	<u>1,183.6</u>
	<u>-</u>	<u>-</u>	<u>-</u>	<u>216.4</u>	<u>216.4</u>
<b>Actual outstanding debt:</b>					
Series A debenture <sup>3</sup>				160.0	160.0
Series B debenture <sup>3</sup>				200.0	200.0
Series C debenture <sup>3</sup>				75.0	75.0
Series D debenture <sup>3</sup>				75.0	75.0
Series E debenture <sup>3</sup>				200.0	200.0
Other external and internal debt	<u>163.6</u>	<u>140.4</u>	<u>304.0</u>	<u>11.0</u>	<u>315.0</u>
<b>Total outstanding</b>	163.6	140.4	304.0	721.0	1,025.0

At March 31, 2014, the debt burden ratio for the total outstanding debt is 3.8% and the associated viability ratio is 1.17. The ratio for debt burden plus pension special payments is 6.4%.

<sup>2</sup> Allocations include borrowing approved by Business Board, plus contingency for donations targets and pledges.

<sup>3</sup> The debentures are unsecured with principal to be repaid on maturity dates ranging from 2031 (A) to 2051 (E).

## **ASSESSING DEBT POLICY LIMIT TO DEBT NEEDS**

Debt primarily supports capital projects and pensions. In assessing the appropriateness of a debt strategy, we considered the need for debt together with the need to remain affordable, and for debt servicing to continue to be financially responsible.

Up to March 31, 2014, the Business Board has approved \$1,183.6 million of debt for capital and other projects. Over the next several years to 2019, we estimate that an additional \$235.5 million of debt will be required for new projects not yet approved by the Business Board. In addition to the \$235.5 million, we estimate that we will also need \$17.0 million in bridge financing (5 to 10 years loans) for donations to be received after the completion of capital projects. The table below shows the timing of estimated new debt required for these planned but not yet approved projects.

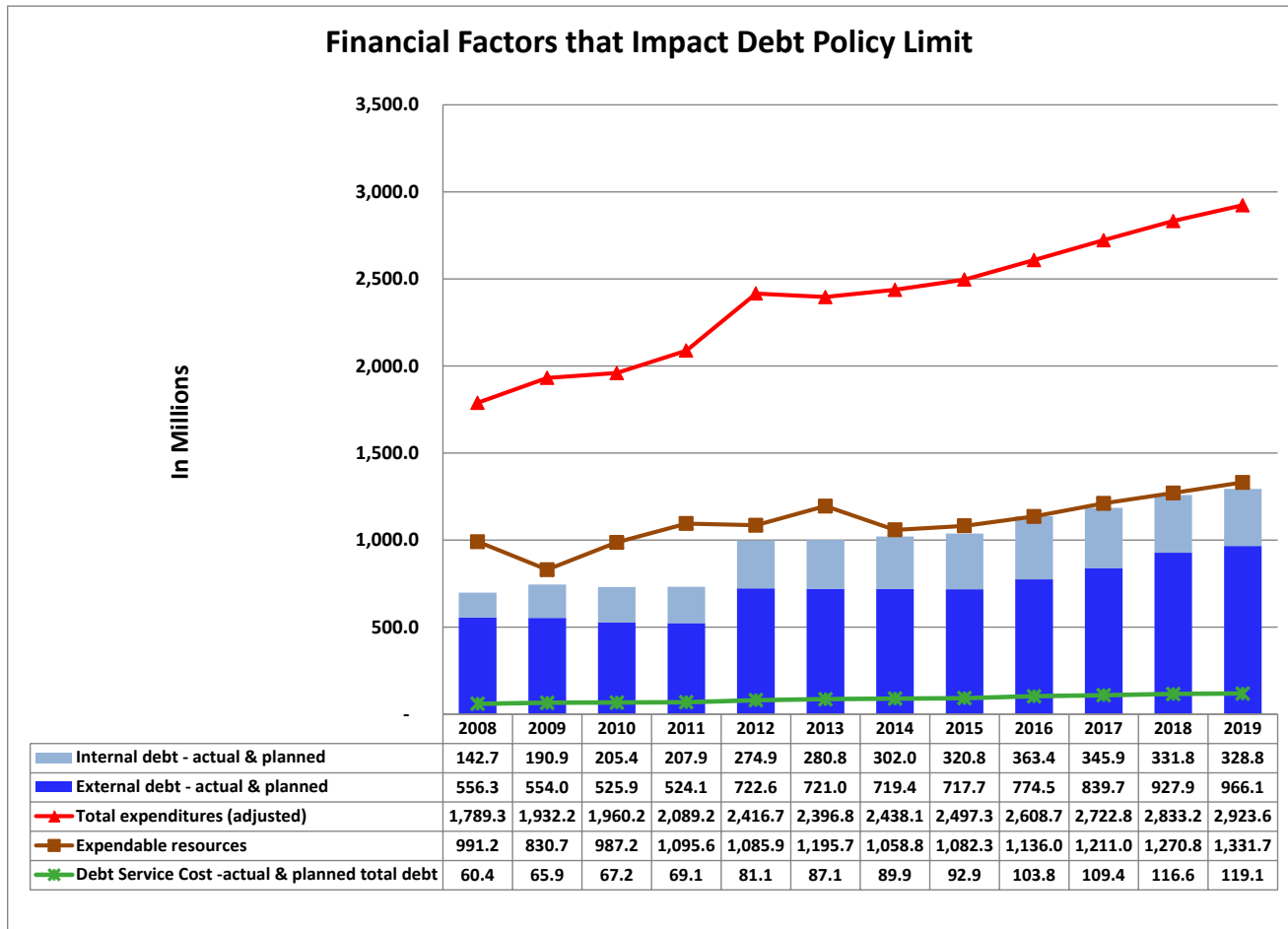
### **Need for Debt (Projects not yet Approved)**

<u>(In Millions of Dollars)</u>			
	Projected Debt Needed	Projected Debt Issuance	EFIP Bridge Financing
2016	65.5	58.5	7.0
2017	77.0	67.0	10.0
2018	70.0	70.0	
2019	<u>40.0</u>	<u>40.0</u>	-
Total to 2019	252.5	235.5	17.0

Please note that the timing above reflects the estimated time when the debt is issued. During the construction period, financing is absorbed by EFIP as short-term bridge financing and is not included as debt.

At March 31, 2014, the unallocated portion of the debt policy limit was \$216.4 million. This, together with \$107.4 million of EFIP loans that are expected to be gradually repaid over the years (from \$12.9 million to \$21.5 million each year), will be more than sufficient to meet the current planned debt needs if the debt policy limit remains around \$1,400 million by 2019. Since the debt policy limit is based on total expenditures (adjusted for major non-cash items such as depreciation and unfunded pension and employee future benefits) that are expected to grow slowly and steadily over the years, the debt policy limit is also expected to grow slowly and steadily.

To project the growth of the debt policy limit, we have projected the financial factors that impact the debt policy limit. The following graph shows a steady increase in total expenditures, but it also shows a decrease of expendable resources in 2014 with modest increases from 2014 to 2019.



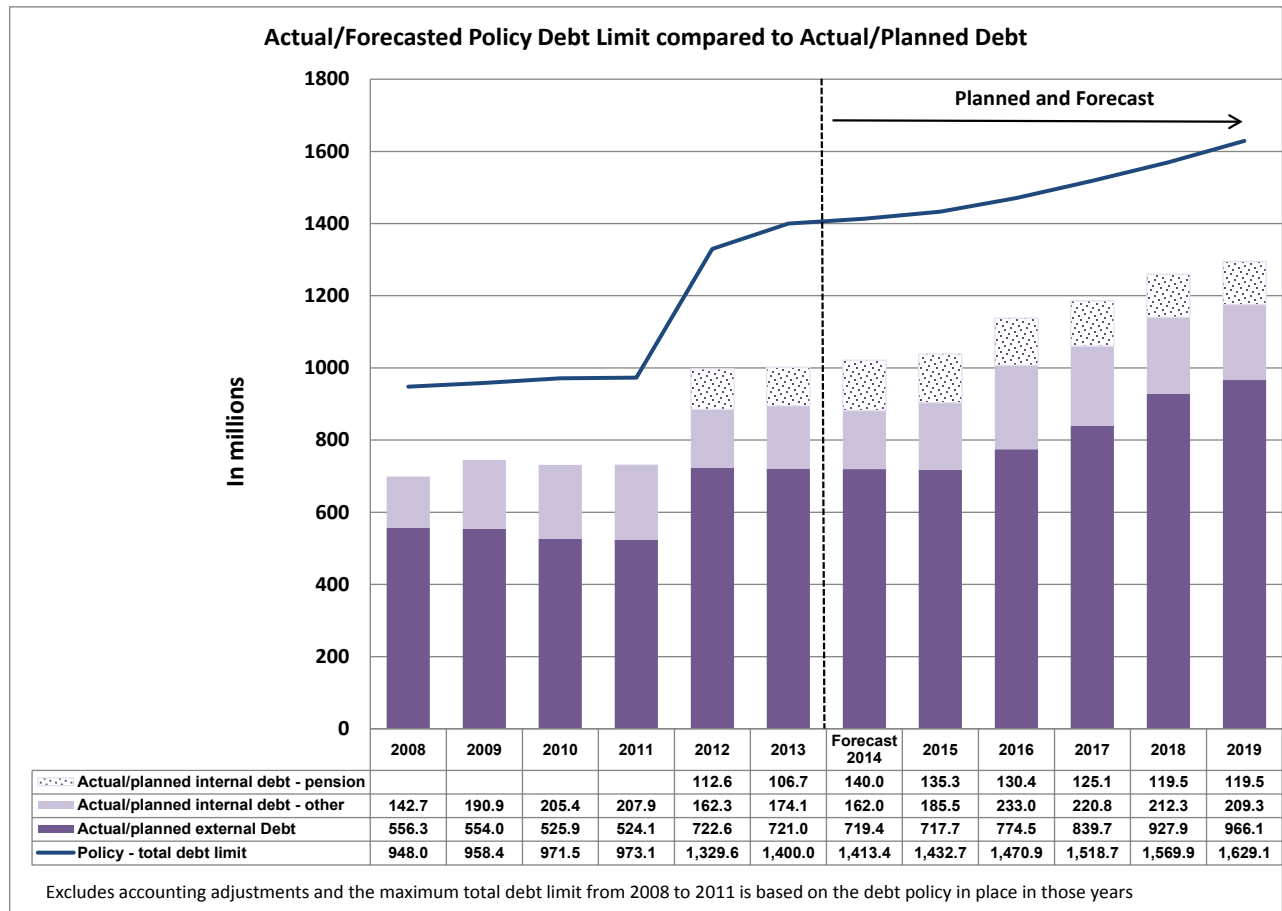
These projections reflect the following assumptions:

- 2014 financial forecast and 2014-15 long-range operating budgets with particular focus on the anticipated growth rates of both the operating expense and revenue budgets.
- Preliminary ancillary budgets 2014 to 2019.
- Projected increases in pension and other employee future benefits incorporating UofT funding strategy for pension approved by Business Board in May 2012.
- Divisional reserves to increase at a slower rate with annual transfers from operating fund towards planned capital projects and matching programs.
- We have incorporated capital construction costs for projects that have been approved by Business Board. For the outer years, we have also attempted to model future

capital constructions costs for projects not yet approved. Furthermore, we have incorporated the effect of potential bridge financing and issue of internal and external loans.

- Investment return on endowments and other long-term funds is forecasted to be at target.
- We have built in modest growth in internally designated endowments and deferred contributions.
- New external debt is assumed to be issued in the form of debentures to be paid in 40 years. Debt service costs for new external debt consist of debt divided by 40 years plus interest at a rate of 5.5%. Debt service costs for new internal loans consist of principal and interest repayment of amortizing loans over 25 years with an interest rate of 5.5%. Debt service cost for interest only loans to bridge finance donations consist of interest of outstanding debt calculated using a rate of 5%.

Based on the assumptions above, the following graph shows the forecasted total debt policy limit (calculated with a debt burden ratio of 5%) compared to actual and planned debt.



Based on the projections above, the debt policy limit (determined on a debt burden ratio of 5%) for future years will provide enough financing for the planned projects and will leave room for strategic academic priorities associated with capital projects not yet planned. Material increases in interest rates would negatively impact this projection as they would increase the cost of new debt, increasing the debt burden ratio, and thus reducing the debt policy limit. Furthermore, as discussed later in the Financial Parameters section, the viability ratios associated with these projected debt policy limits are expected to be below 0.8 from 2014 to 2016. This results from the anticipated decrease of expendable resources in 2014 (mainly due to an unusually large contribution to pension plans) followed by only modest increases in reserves from 2015 to 2019. If we were to adjust the debt policy limit to a viability ratio of 0.8 for the years 2014 to 2016, the debt policy limits would be reduced in those years between \$90 million (2014) and \$51 million (2016). Even with these adjustments, the reduced debt policy limit should provide enough financing for the current planned projects plus future initiatives.

## FINANCIAL PARAMETERS

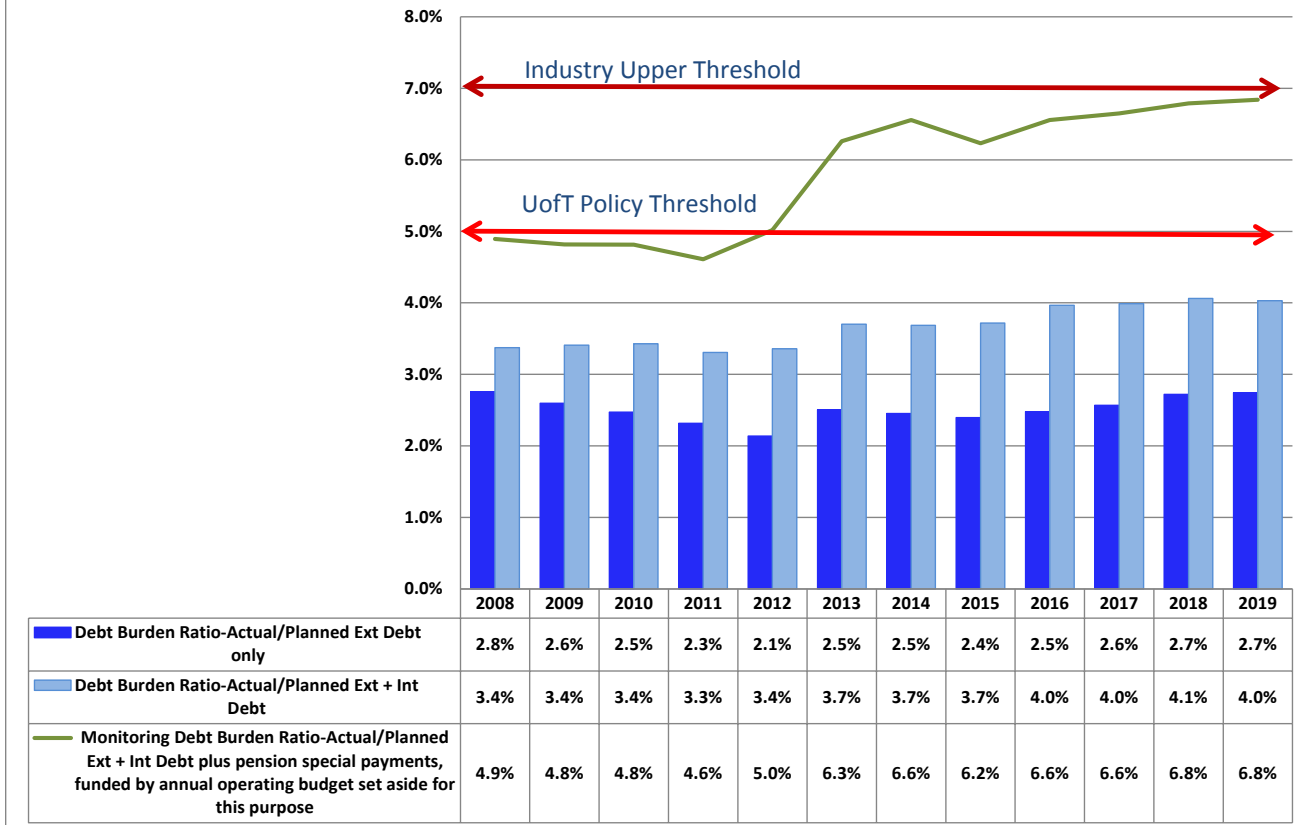
Debt affordability is the financial parameter that determines the debt policy limit. Debt capacity is the secondary financial parameter that is taken into consideration when setting the debt policy limit each year.

**Debt affordability** is defined as the amount that can be made available to pay interest and repay outstanding debt, both external and internal. It is measured via income statement ratios and is impacted by the interest rate at which the debt is financed and the time period over which principal payments are made on the debt. The debt strategy sets the acceptable debt burden ratio (principal plus interest/total expenditures) at 5%, well within a recommended upper limit of 7% (Strategic Financial Analysis in Higher Education – Seventh edition).

In addition to the debt burden ratio, as a general provision for future adverse events due to the size of the pension deficit and the resulting need for pension related contributions over many years by the University, an additional metric has been developed to capture this impact. An additional ratio that adds special budgeted pension payments (under the pension contribution strategy) to principal plus interest on actual and planned internal and external debt, and continues to be divided by total expenditures will serve only for an additional information purpose.

The following graph shows the actual debt burden ratios for external debt alone and the actual debt burden ratios for both external and internal debt up to 2013. The forecasted debt burden ratios include debt that have been already approved by Business Board plus additional debt for projects that are being planned for future years, which have not been submitted to the Business Board for approval. In addition, the additional ratio (that includes pension special payments) to 2013 and the forecasted ratios to 2019 have been included in the graph.

### Debt Burden Ratios for Actual/Planned External and Internal Debt and Additional Debt Burden Ratio (includes Special Payments to Pension)



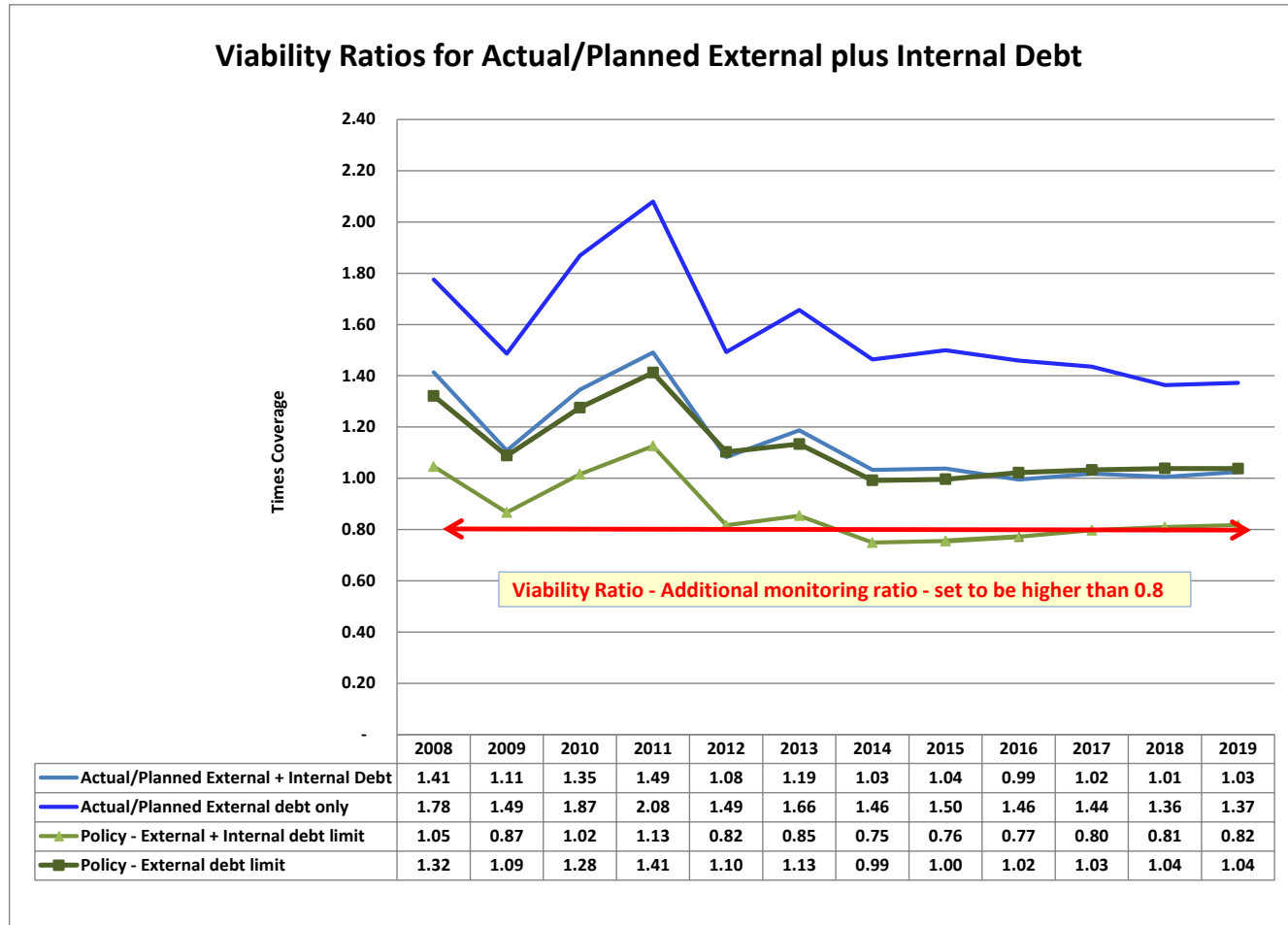
Based on the projected expenses and the projected debt service costs for actual and planned debt (both for approved projects and those not yet approved), the debt burden ratios for the future years will increase slightly, but will remain below the 5% maximum policy limit. The additional ratio, which adds special pension payments (funded from operating budget) to debt burden ration, is expected to be between the debt policy limit of 5% and the 7% industry upper threshold.

**Debt capacity which is considered a moderating factor** is defined as the amount that can be borrowed based on funds on hand that could be used to repay the outstanding debt as of the balance sheet date. It is measured via a balance sheet ratio (expendable resources/debt). The debt strategy identifies a viability ratio of 0.8 as the appropriate threshold for our institution that balances our financial, operating and programmatic objectives. As indicated above, this is an additional ratio that is taken into consideration once the debt policy limit is set using the debt burden ratio of 5%.

The graph below shows the viability ratios based on actual debt (external only and both internal plus external debt) up to 2013 and the forecasted viability ratios based on

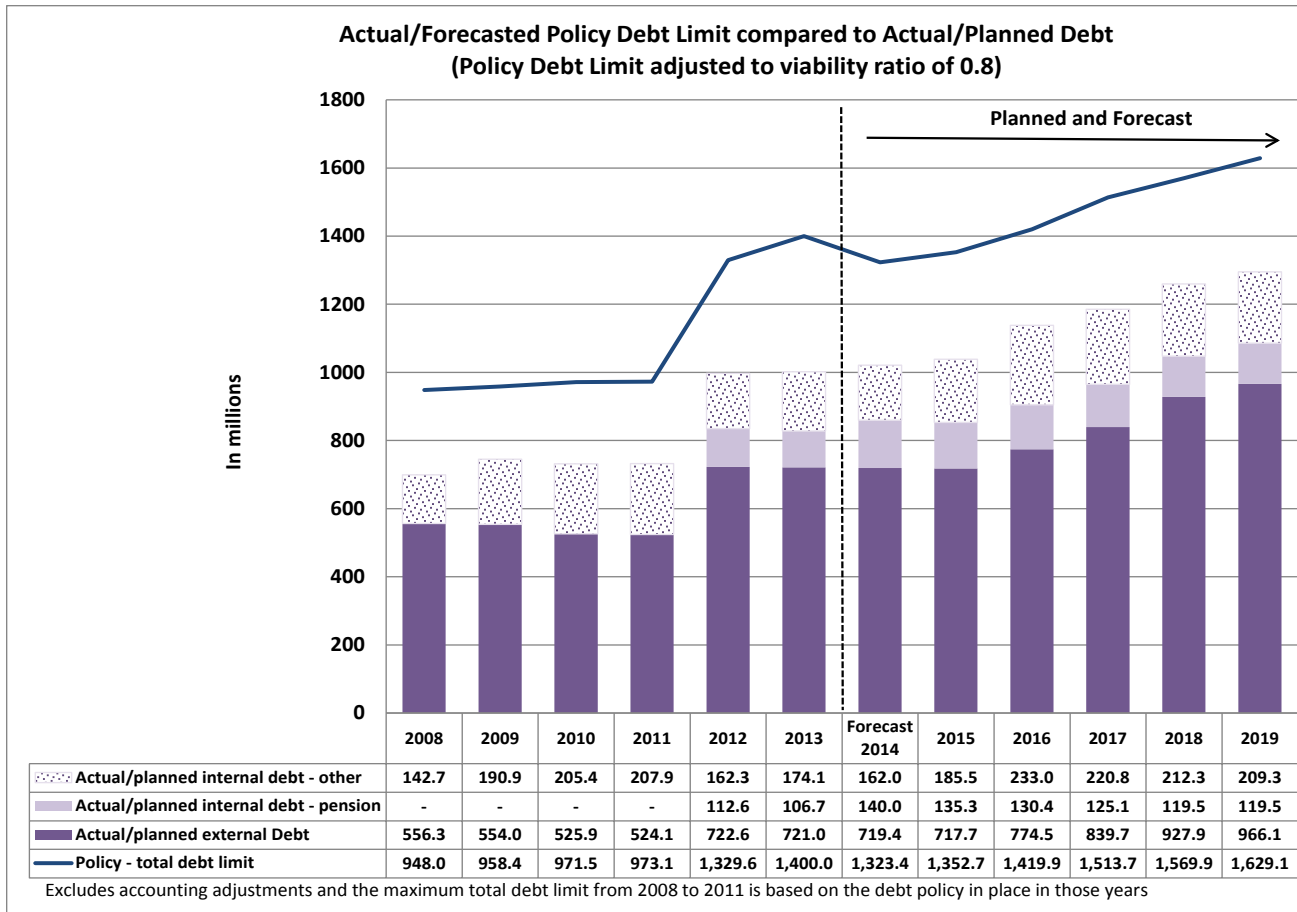


actual and planned debt for approved and not yet approved projects up to 2019. It also shows the actual and forecasted viability ratios based on the debt policy limit, both external plus internal, and then for external debt alone.



The graph above shows that the viability ratios for the actual and planned debt are expected to be above the lower threshold of 0.8 for all the years being forecasted. However, the viability ratios associated with the forecasted debt policy limits are expected to be below 0.8 for the 2014, 2015 and 2016 years.

The graph below shows the projected debt limit if it was reduced to a viability ratio of 0.8 during the projected period where it is expected to fall below 0.8.



If the policy debt limit were adjusted to a viability ratio of 0.8 from 2014 to 2016, the debt burden ratios associated with the adjusted total policy debt limit would range from 4.7% to 4.8%. When we reach each year, if the viability ratio associated with the actual debt policy limit happens to be below 0.8, we will evaluate its significance in setting the debt policy limit for that year.

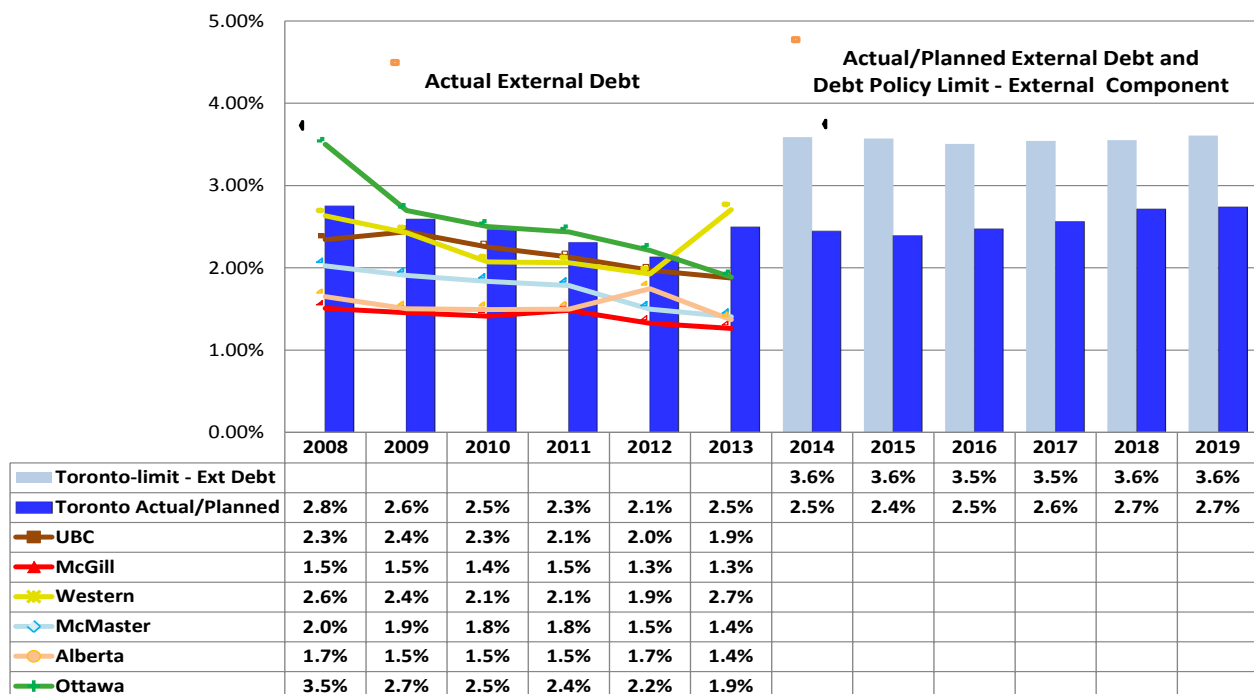
It has been a little over a year since the current debt strategy was approved in November 2012. We continue to believe that using the debt burden ratio to assess the University's ability to service debt and using the viability ratio as a secondary ratio to monitor the University's capacity to repay debt are financially prudent. Limiting the cost of servicing debt to quite a small percentage, 5% of total expenditures, helps the University balance what is spent ON the classroom with what is spent IN the classroom. Using an additional parameter to monitor the University's debt adds to the University's caution in setting the debt policy limit.

## BENCHMARKING

To assess the current debt strategy, we are also comparing the University's debt ratios to those of selected Canadian and U.S. universities.

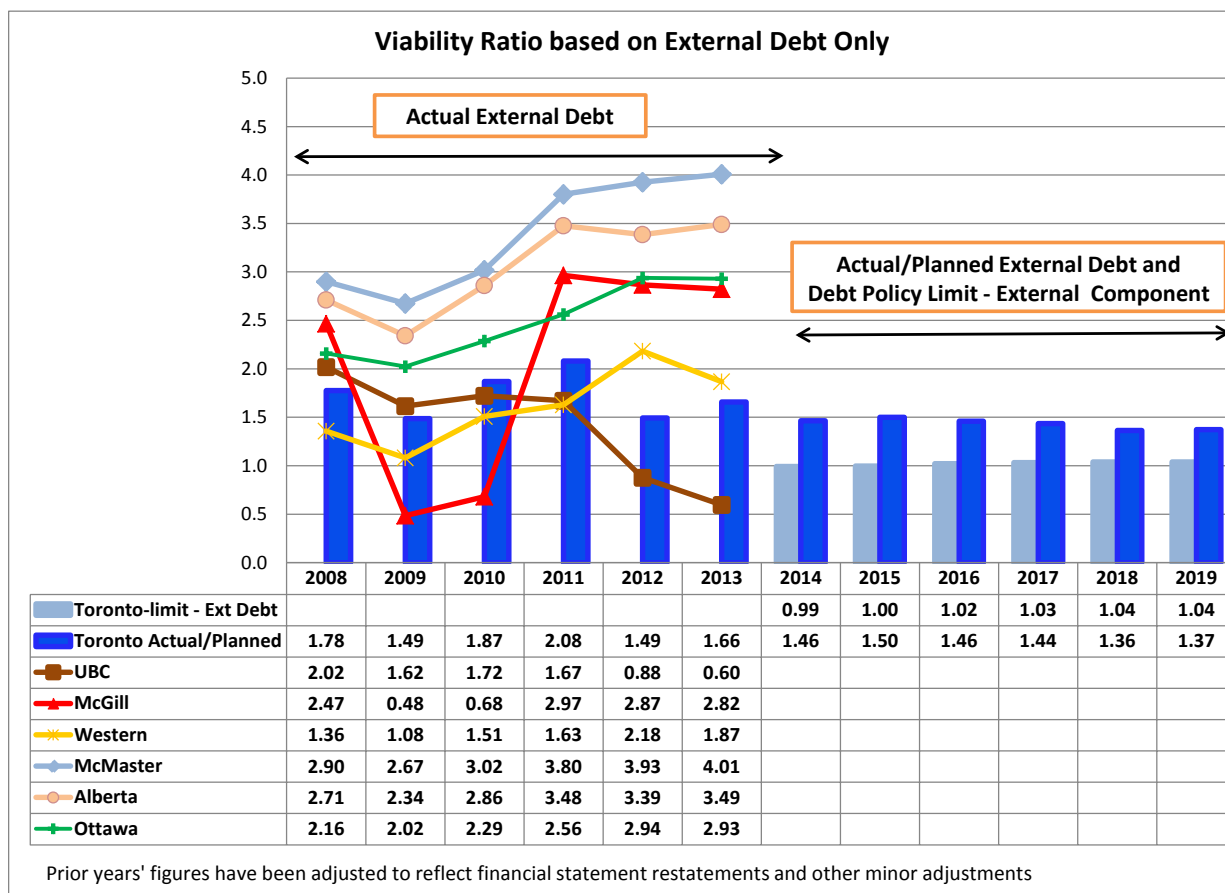
For the benchmarking against Canadian universities, we have used the University's actual and forecasted debt burden and viability ratios and compared them to the debt burden and viability ratios that we have calculated for these other Canadian universities. Since these two ratios are not readily available, we have obtained the data from their published financial statements and have made some minor necessary adjustments to their financial data to make them comparable to the data used to calculate the University of Toronto ratios. For example, in calculating the ratios for McGill University, we have excluded the debt, debt service cost and interest expense related to the debt that is secured by the Government of Quebec. For universities that have issued debentures, like UofT, we have used the same approach to calculate the annual debt service cost for the principal component by dividing the debt by the number of years from the issue date to the maturity date. Finally, since information on internal debt is not disclosed in the financial statements and is not readily available, we have calculated the ratios based only on external debt. The two graphs below show the debt burden ratios and viability ratios.

**Debt Burden Ratios Based on External Debt Only**



Prior years' figures have been adjusted to reflect financial statement restatements and other minor adjustments

The university's debt burden ratio on actual external debt is higher than most of the Canadian Universities in the chart above. UofT has led the way and built its debt programme to a greater extent than other Canadian universities. Canadian universities have not traditionally relied on debt-financing to the same extent as U.S. universities and this is reflected in the ratios.

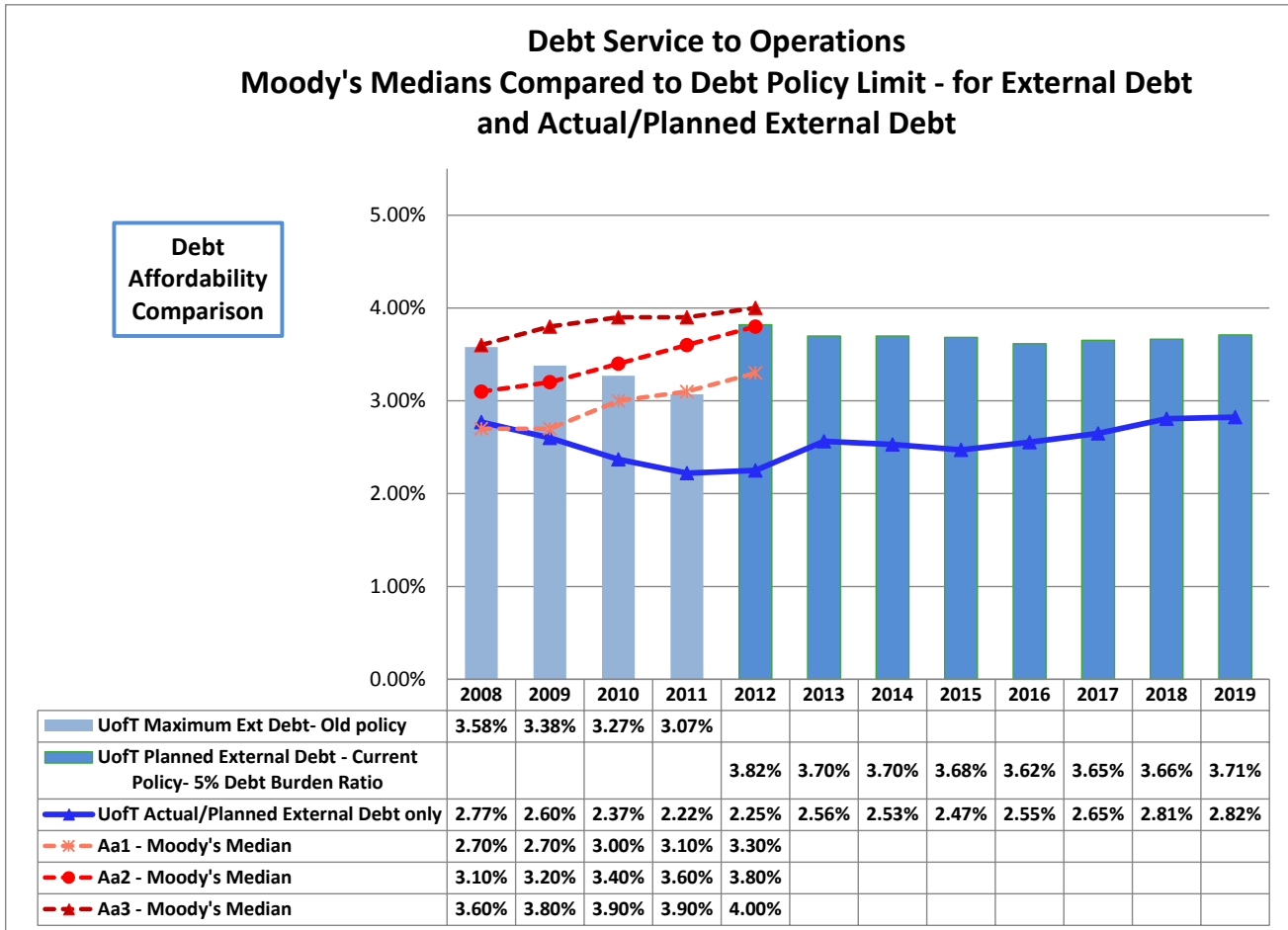


However, when comparing Toronto to U.S. universities, in similar investment grade rating categories, we see a different picture.

For benchmarking against U.S. universities, we used the Moody's U.S. Public College and University Medians (fiscal 2012) which provided comparison data for selected U.S. universities. The University of Toronto is not included in this report. There are 14 universities at the Aa1 rating level, 42 universities at the Aa2 level, and 46 universities at the Aa3 level. At each rating level, the median university ratio is displayed. Only external debt is considered.

As a debt affordability comparison, we selected the ratio of debt service to operations. This ratio is very similar to the debt burden ratio, but has one difference. Scholarships, fellowships and bursaries are deducted from total expenditures since Moody's considers this

category to represent tuition discounting. The U of T ratio reflected here has been adjusted for that difference and is, therefore, slightly different than the debt burden ratio displayed in the other charts.

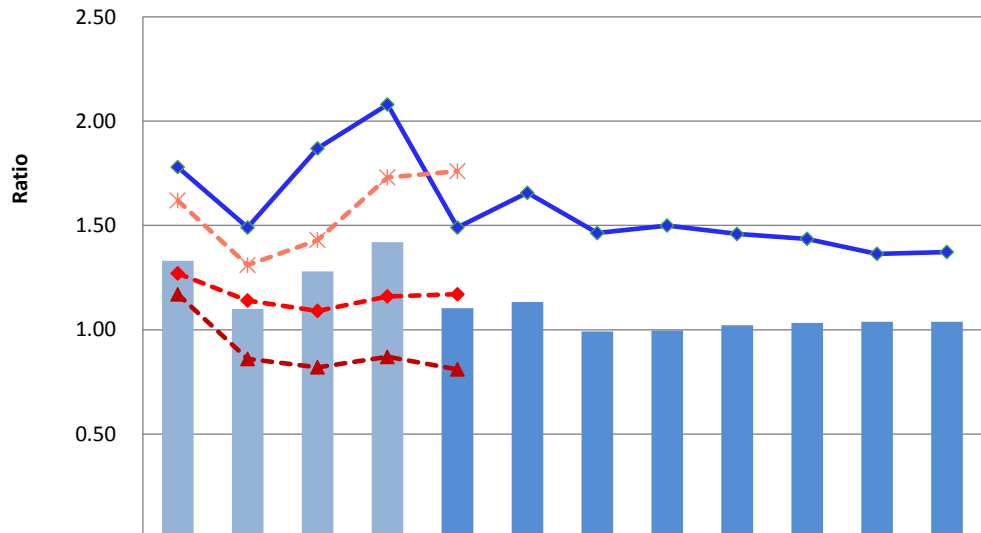


As you can see from the chart above, the 2012 ratio for the three rating level ranges from 3.3% to 4.0%. The 2012 UofT ratio was 2.25%. On the basis of actual and planned external debt, this ratio is projected to trend to 2.82% by 2019. The external debt policy limit is projected to be 3.71% by 2019.

The next chart provides the debt capacity comparison, in the form of the viability ratio. This Moody's ratio is calculated in exactly the same way as the one used elsewhere in this paper.

**Expendable Resources to External Debt  
Moody's Medians compared to Debt Policy Limit  
for External Debt and Actual/Planned External Debt**

**Debt  
Capacity  
Comparison**



	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
UofT Maximum Ext Debt- Old policy	1.33	1.10	1.28	1.42								
UofT Planned External Debt - Current Policy- 5% Debt Burden Ratio					1.10	1.13	0.99	1.00	1.02	1.03	1.04	1.04
UofT Actual/Planned External Debt only	1.78	1.49	1.87	2.08	1.49	1.66	1.46	1.50	1.46	1.44	1.36	1.37
Aa1 - Moody's Median	1.62	1.31	1.43	1.73	1.76							
Aa2 - Moody's Median	1.27	1.14	1.09	1.16	1.17							
Aa3 - Moody's Median	1.17	0.86	0.82	0.87	0.81							

As you can see from the chart above, the 2012 ratio for the three rating levels ranges from 0.81 to 1.76. The 2012 UofT ratio was 1.49 and is projected to trend down to 1.37 by 2019. The external debt policy is projected to be 1.04 by 2019.

In summary, compared to selected Canadian universities, UofT has a higher proportion of debt service costs to total expenditures. In terms of expendable resources to pay outstanding debt, UofT also has lower expendable resources to debt ratios. However, compared to U.S. universities, UofT has a lower debt service cost than the median of universities with our same credit rating (Aa2), and higher expendable resources to debt than the median of universities with our same credit rating.

**Credit Ratings**

Credit ratings give lenders an assessment of a borrower's ability to repay debt. The credit rating also influences the interest rate paid by the borrower, reflecting how much the lender wants to be compensated for assuming the risk related to repayment of the debt and the covenants placed on the borrower by the lenders.

The University has three credit ratings – from Moody's Investors Service, from Standard and Poor's and from Dominion Bond Rating Service. The following table shows the credit rating definitions and the ratings assigned to our U.S. and Canadian peers.

**Credit Rating Comparison  
University of Toronto with US and Canadian Peers at June 2013**

<b>Rating Definitions</b>	<b>Moody's Investors Service</b>	<b>Standard &amp; Poor's</b>	<b>Dominion Bond Rating Service</b>
Best quality	Aaa	AAA	AAA
Next highest quality	Aa1	AA+	AA(high)
and so on, declining	Aa2	AA	AA
↓	Aa3	AA-	AA(low)
	A1	A+	A(high)
	A2	A	A
	and so on	and so on	and so on

<b>University</b>	<b>Moody's Investors Service</b>	<b>Standard &amp; Poor's</b>	<b>Dominion Bond Rating Service</b>
<b>PROVINCE OF ONTARIO</b>	<b>Aa2</b>	<b>AA-</b>	<b>AA(low)</b>
University of Michigan	Aaa	AAA	
University of Texas system	Aaa	AA+	
University of Washington	Aaa	AA+	
University of British Columbia	Aa1	AA+	
Queen's University		AA+	AA
University of Pittsburgh	Aa1	AA	
University of Minnesota	Aa1	AA	
Ohio State University	Aa1	AA-	
University of California	Aa1	AA-	
<b>University of Toronto</b>	<b>Aa2</b>	<b>AA</b>	<b>AA</b>
University of Ottawa	Aa2		AA
University of Western Ontario		AA	
McMaster University		AA-	AA(low)
McGill University	Aa2	AA-	
University of Arizona	Aa2		
University of Illinois	Aa3	A	

Source: Credit rating agencies' websites and reports.

As the above chart illustrates, the University of Toronto continues to maintain excellent credit ratings, absolutely and in comparison to our peers and is rated above the Province of Ontario by two rating agencies.



## **INTERNAL DEBT**

The current debt strategy sets a single limit to include both internal and external debt, with the split between internal and external debt to be determined by expendable cash flows deemed to be available for long-term investment.

Although internal and external debt are considered to be fungible within the overall debt strategy, the maximum internal debt component has been set at 40% of expendable cash to recognize the need for liquidity and to provide for possible future changes to cash flow patterns. The current target of \$350 million (including \$150 million debt for Pension funding) represents 28.7% of the expendable cash balance at April 30, 2013.

Based on cash flow projections, the \$350 million allocated to internal debt will continue to be below the 40% of EFIP limit established by the current strategy throughout the period of study.

# External Debt and Planned Repayment of Debentures

The University’s external debt programme consists almost entirely (98.5%) of unsecured debentures. A master trust indenture sets out the terms and conditions under which the debentures have been issued, and how they must be repaid.

A total amount of \$710 million fixed rate debentures have been issued for 30-year and 40-year terms, with interest payable on a semi-annual basis, and with the principal repayment at various maturity dates, ranging from 2013 to 2051 as follows:

Series A	July 18, 2031	\$160 million
Series B	December 15, 2043	\$200 million
Series C	November 16, 2045	\$ 75 million
Series D	December 13, 2046	\$ 75 million
Series E	December 7, 2051	\$200 million

A self-imposed (that is not specified by the master trust indenture) sinking fund, entitled the Long-Term Borrowing Pool (LTBP) has been established by the University to accumulate funds for the repayment of the debentures. The source of the funds being accumulated in the LTBP is the principal portion of blended principal and interest payment being made by internal borrowers (faculties, divisions and central departments) on loans that they have taken out under the University’s internal borrowing programme.

At April 30, 2013, a total of \$131.7 million has been accumulated in the LTBP towards repayment of the debentures.

The other external debt, totaling \$11 million, represents several small loans, most of which date from before the commencement of the debenture programme in 2001. Each one has its own agreement and repayment program. Most of these individual loans will be fully paid down over the next few years.

## Conclusion

The current debt strategy has been in place for just over one year. This first annual report on the functioning of the strategy demonstrates that, provided interest rates remain relatively stable, it will deliver the debt levels needed to support the University's capital needs within the affordability parameters that we have set ourselves.

The debt policy limit established under this program allows for more debt than that currently being taken on by selected Canadian comparators; however, it reflects less debt than that taken on by U.S. comparators in the same (Moody's Aa2) strong investment credit rating grade as that assigned to UofT.

As noted in the detail, the debt policy limit encompasses both an internal debt component and an external debt component. The analysis shows that the internal debt component, which represents a long-term investment by the University's expendable funds investment pool, is expected to continue to be available for this purpose throughout the projection period. The report also describes the external debt and shows that progress is being made to accumulate funds needed to repay the debentures, which repayment is required over the period from 2031 to 2051.